

Message Text

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C O N F I D E N T I A L SECTION 01 OF 03 LONDON 01399

NOFORN

E.O. 11652: XGDS-1

TAGS: ENRG UI

SUBJECT: NORTH SEA OIL: MAJORITY STATE PARTICIPATION
BEGINS TO TAKE SHAPE

1. SUMMARY: WE HAVE OBTAINED THE FIRST CLEAR INDICATION OF WHAT A MAJORITY STATE PARTICIPATION AGREEMENT IS APT TO LOOK LIKE. THE INITIAL 51 PERCENT PARTICIPATION AGREEMENT TENTATIVELY NEGOTIATED BY HMG WITH A SMALL BRITISH OIL COMPANY CALLS FOR A) 100 PERCENT OF DEVELOPMENT FINANCING TO BE RAISED BY THE COMPANY, B) FULL BRITISH NATIONAL OIL CORPORATION (BNOC) INVOLVEMENT IN ALL MATTERS CONSIDERED BY OPERATING AND MANAGEMENT COMMITTEES ESTABLISHED UNDER THE LICENSING AGREEMENT, BUT WITH CIRCUMSCRIBED VOTING RIGHTS, AND C) A BNOC OPTION ON SIX MONTHS NOTICE TO RETAIN THE PETROLEUM PRODUCED ATTRIBUTABLE TO ITS 51 PERCENT SHARE SO LONG AS BNOC IS WILLING TO PAY WHAT AMOUNTS TO A FAIR MARKET PRICE. IT IS EXPECTED, HOWEVER, THAT THERE WILL BE NUMEROUS VARIATIONS OR DEPARTURES FROM THIS DRAFT IN THE
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AGREEMENTS WHICH WILL BE NEGOTIATED WITH OTHER OIL COM-

PANIES, PARTICULARLY TO PROVIDE FOR RETENTION OF CRUDE FOR A NUMBER OF YEARS BY COMPANIES WITH ESTABLISHED CRUDE OUTLETS. WHILE NEGOTIATIONS WILL CONTINUE FOR AN EXTENDED PERIOD, AT LEAST THROUGH 1976, IT APPEARS THE LABOR GOVERNMENT HAS ONCE AGAIN TAKEN THE FIRST STEPS TOWARD COMPROMISE OF ITS VAGUELY STATED IDEOLOGICAL GOALS IN RESPONSE TO OIL INDUSTRY OPPOSITION AND, ABOVE ALL, THE HARD ECONOMIC FACTS OF LIFE. BRITAIN'S DIMINISHED ABILITY TO BORROW ON THE INTERNATIONAL CAPITAL MARKET UNDOUBTEDLY HAS INFLUENCED HMG TO FOREGO ITS ORIGINAL INTENTION TO FINANCE ITS 51 PERCENT SHARE OF FUTURE DEVELOPMENT COSTS. FURTHER FLEXIBILITY ALSO IS LIKELY IN HMG DEALINGS WITH MAJOR OIL COMPANIES WHICH ARE CERTAIN TO INSIST ON MAINTAINING OFFTAKE RIGHTS TO NORTH SEA CRUDE PRODUCTION FOR SEVERAL YEARS AT THE LEAST. NEVERTHELESS, HMG IS LIKELY TO PRESS STRONGLY FOR SUFFICIENT CONTROL OVER DISPOSITION OF CRUDE IN TIMES OF CRISIS OR EMBARGO TO ENABLE IT TO INFLUENCE THROUGH BNOC OIL COMPANY DECISIONS ON SHIPMENTS OUTSIDE BRITAIN. FINALLY, HMG WILL INSIST THAT BNOC BE ENGAGED IN ALL DELIBERATIONS OF OPERATING AND MANAGEMENT COMMITTEES ESTABLISHED UNDER LICENSE AGREEMENTS SO THAT BNOC CAN ACQUIRE INFORMATION AND EXPERIENCE WHICH WILL ALLOW IT TO SERVE BOTH AS A COMMERCIALY ORIENTED OIL COMPANY AND, WE SUSPECT, AS AN INFORMAL REGULATORY ARM OF THE DEPARTMENT OF ENERGY. END SUMMARY.

2. AFTER 18 MONTHS OF BACKING AND FILLING SINCE THE LABOR GOVERNMENT'S WHITE PAPER ON OFFSHORE OIL AND GAS POLICY WAS ISSUED IN JULY 1974, WE HAVE OBTAINED FROM INDUSTRY SOURCES THE FIRST CLEAR INDICATION AS TO WHAT A MAJORITY STATE PARTICIPATION AGREEMENT IS APT TO LOOK LIKE. VARIATIONS ON THIS FIRST PROPOSED AGREEMENT ACCORDING TO INDIVIDUAL CIRCUMSTANCE ARE NOT ONLY POSSIBLE BUT PROBABLE, AND IT SHOULD THEREFORE BE VIEWED AS THE REAL BEGINNING, NOT THE END, OF PARTICIPATION NEGOTIATIONS. THE DRAFT AGREEMENT NEGOTIATED BUT NOT YET SIGNED BY THE SECRETARY OF STATE FOR ENERGY AND BNOC WITH TRICENTROL (PROTECT--SEE PARA. 6 BELOW), A SMALL BRITISH COMPANY WITHOUT REFINING OR DISTRIBUTION OUTLETS OF ITS

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OWN, PROVIDES FOR A 51 PERCENT ASSIGNMENT OF ITS 10 PERCENT INTEREST IN THE THISTLE FIELD TO BNOC AND DEALS WITH FINANCING, BNOC INVOLVEMENT IN OPERATIONS AND DISPOSITION OF CRUDE PETROLEUM PRODUCTION. THE FINAL VERSION COULD DIFFER MATERIALLY SINCE IT MUST STILL BE APPROVED BY TRICENTROL'S PARTNERS IN THISTLE.

3. THE FINANCING PROVISION OF THE PROPOSED PARTICIPA-

TION AGREEMENT IS A MODEL OF UNANTICIPATED SIMPLICITY.
PREFATORY REMARKS PROVIDE MERELY THAT TRICENTROL--NOT
BRITISH NATIONAL OIL CORPORATION (BNOC) OR THE GOVERN-
MENT--HAS THE RESPONSIBILITY TO RAISE MONEY TO ENABLE
TRICENTROL TO DEFRAY ALL DEVELOPMENT EXPENSES. THERE IS
NO OTHER REFERENCE WHATSOEVER TO FINANCING, SAVE THE

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USUAL CONTRACTUAL REFERENCES TO FINANCING DOCUMENTS.

4. REGARDING OPERATIONAL INVOLVEMENT OF BNOC, PROVISION
IS MADE FOR THE STATE ENTERPRISE TO BECOME A PARTY TO
THE THISTLE OPERATING AGREEMENT, TO BE REPRESENTED ON
OPERATING OR MANAGEMENT COMMITTEES AND TO VOTE ACCORDING-
LY. BUT BNOCS VOTING PRIVILEGE IS CIRCUMSCRIBED IN
THAT IT IS BOUND TO OBTAIN TRICENTROL'S PRIOR CONSENT IN
WRITING TO ANY VOTE WHICH WOULD INCREASE TO A MATERIAL
EXTENT THE LIABILITIES OR FINANCIAL OBLIGATIONS OF
TRICENTROL UNDER THE VARIOUS OPERATING AND UNITIZATION
AGREEMENTS.

5. ON DISPOSITION OF THE CRUDE OIL FLOWING FROM THE ASSIGNED 51 PERCENT INTEREST, BNOC HAS AN OPTION, WHICH CAN BE EXERCISED ON SIX MONTHS NOTICE, TO ELECT TO RETAIN ALL PETROLEUM ATTRIBUTABLE TO ITS INTEREST, LESS ANY PETROLEUM TAKEN IN KIND AS ROYALTY OIL. THE AMOUNT PAID WOULD INSURE (TAKING INTO ACCOUNT METHOD OF PAYMENT, CURRENCY OF PAYMENT, MARKET VALUE (AS DEFINED IN CONFIDENTIAL

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THE OIL TAXATION ACT OF 1975) AND OTHER FACTORS AS TRICENTROL MAY DEMONSTRATE) THAT TRICENTROL IS PLACED IN THE SAME FINANCIAL POSITION AS IT WOULD HAVE BEEN IN HAD TRICENTROL TAKEN DELIVERY OF SUCH PETROLEUM. HOWEVER, IF TRICENTROL CAN DEMONSTRATE THAT IT IS ABLE TO ENTER INTO A BONA FIDE CONTRACT ON AN ARM'S LENGTH BASIS FOR DISPOSAL OF THE CRUDE, THE COMPANY SHALL BE ENTITLED TO PROCEED WITH THE CONTRACT UNLESS BNOC AGREES WITHIN 30 DAYS OF NOTIFICATION TO CONTRACT FOR THE CRUDE ON THE SAME TERMS AND CONDITIONS.

6. THE SPECIFIC PROVISIONS OF THE DRAFT TRICENTROL AGREEMENT HAVE BEEN CLOSELY HELD AND IN PART MAY BE CONSIDERED OF A COMMERCIAL PROPRIETARY NATURE. TRICENTROL SHOULD NOT BE CITED BY NAME IN DISCUSSIONS WITH INDIVIDUAL OIL COMPANIES OR FOREIGN GOVERNMENT OFFICIALS DESPITE THE FACT ONE OR TWO PRESS ARTICLES HAVE RUMORED THE EXISTENCE OF SUCH AN AGREEMENT.

7. COMMENT: IT APPEARS HMG HAS BEGUN TO FOLLOW A COMPROMISE COURSE SIMILAR TO THAT PURSUED RESPECTING THE PETROLEUM REVENUE TAX AND THE PETROLEUM BILL NEGOTIATIONS. IN MOST RESPECTS, HMG'S EVOLVING FALLBACK POSITION ON PARTICIPATION FOLLOWS THE COMPARATIVELY MODERATE VIEWS LONG SINCE ESPOUSED BY ITS CHIEF PARTICIPATION NEGOTIATOR CHANCELLOR OF THE DUCHY OF LANCASTER HAROLD LEVER. TO THE EXTENT THERE WERE DIFFERENCES, THE HARDLINERS IN THE DEPARTMENT OF ENERGY LED BY SECSTATE FOR ENERGY TONY BENN AND RECENTLY RESIGNED MINISTER FOR ENERGY LORD BALOGH (NOW DEPUTY CHAIRMAN OF BNOC) SEEMINGLY HAVE LOST OUT AT CABINET LEVEL TO LEVER, AND CHANCELLOR HEALEY AND PAYMASTER GENERAL DELL OF TREASURY. EVEN BNOC CHAIRMAN LORD KEARTON HAS MADE KNOWN PRIVATELY THAT HE WAS LESS THAN ENCHANTED BY THE LABOR MANIFESTO VIEW OF MAJORITY STATE PARTICIPATION.

8. PERHAPS MOST INSTRUMENTAL IN BRINGING ABOUT THIS EVOLUTION OF HMG VIEWS HAVE BEEN THE COLD ECONOMIC FACTS OF LIFE. AT LEAST INsofar AS FINANCING IS CONCERNED, THE COMBINED PRESSURES OF INDUSTRY OPPOSITION, BASED IN PART

ON ADVERSE TAX CONSEQUENCES IN THE US FOR AMERICAN COM-
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PANIES, AND THE HIGH BORROWING COSTS INVOLVED (WITH AN
ALREADY VERY HEAVY BUDGET DEFICIT) HAVE LED TO COMPLETE
ABANDONMENT OF PREVIOUS INSISTENCE ON BNOC PUTTING UP 51
PERCENT OF FUTURE DEVELOPMENT COSTS (FOR WHICH HMG WOULD
HAVE BEEN ENTITLED TO RECEIVE A USUAL BANKER'S RETURN
PLUS A RISK PREMIUM). WHILE IT IS PROBABLE WE WILL SEE
SUCH ARRANGEMENTS FOR SOME SMALLER, LESS WELL-FINANCED
COMPANIES IN NEED OF A FINANCIAL BAIL OUT, IT IS HIGHLY
DOUBTFUL HMG INTENDS TO PUT UP MUCH CASH FOR THIS PUR-
POSE. ON THE CONTRARY, BNOC MAY FIND ITSELF HARD PRESSED
TO MEET ITS OWN SHARE OF DEVELOPMENT EXPENDITURES RE-
QUIRED BY TAKEOVER OF NATIONAL COAL BOARD AND BURMAH'S
NINIAN FIELD INTERESTS, ETC. FROM NATIONAL OIL ACCOUNT
REVENUES (ESSENTIALLY ROYALTY PAYMENTS). MOREOVER, THE
900 MILLION POUND STERLING BORROWING LIMIT AUTHORIZED BY
PARLIAMENT FOR BNOC OPERATIONS COULD BE REVISED DOWNWARD
AS WELL AS UPWARD IF BRITAIN'S FINANCIAL CIRCUMSTANCES
DICTATE RETRENCHMENT ON THIS FRONT.

9. BNOC'S RIGHT TO VOTE UNDER EXISTING OPERATING AGREE-
MENTS WOULD APPEAR TO BE FAIRLY WELL CIRCUMSCRIBED, WITH
LITTLE OPPORTUNITY AFFORDED TO INFLUENCE MAJOR DECISIONS
INsofar AS FIELDS ALREADY UNDER DEVELOPMENT ARE CONCERNED

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UNLESS THE DEPARTMENT OF ENERGY IS PREPARED TO WITHHOLD OR WITHDRAW ITS CONSENT TO DEVELOPMENT PLANS ALREADY UNOFFICIALLY AFDORED A STAMP OF APPROVAL, BNOC WOULD BE UNABLE UNILATERALLY TO INSIST UPON AN INCREASE IN ITS PARTNERS' FINANCIAL OBLIGATIONS FOR FIELD DEVELOPMENT. NONETHELESS, BNOC WOULD HAVE A BLOCKING VOTE AND, MORE IMPORTANT, ITS MERE PRESENCE ON A MANAGEMENT COMMITTEE UNDER AN OPERATING AGREEMENT WOULD PROVIDE HMG WITH THE KIND OF INFORMATION AND EXPERIENCE IT HAS BEEN SO INSISTENT UPON OBTAINING. ONE UNDERLYING BUT LARGELY UNSPOKEN MOTIVATION FOP CONTINUED HMG INSISTENCE ON BNOC PRESENCE IN OPERATING FORA IS THAT SUCH INVOLVEMENT WOULD BE SUPPORTIVE OF THE RELATIVELY WEAK REGULATORY CAPABILITY OF THE CIVIL SERVICE BUREAUCRACY AT THE DEPARTMENT OF ENERGY. BNOC WOULD SUBSTITUTE, IN EFFECT, FOR THE KIND OF ANTI-TRUST LAW ENFORCEMENT AND REGULATORY COMMISSION CONTROL WHICH ARE PREVALENT ON A FEDERAL AND STATE BASIS IN THE UNITED STATES.

10. ON THE ALL IMPORTANT QUESTION OF CONTROL OVER THE
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DISPOSITION OF THE NORTH SEA CRUDE PRODUCED, WE DO NOT BELIEVE THE TRICENTROL AGREEMENT IS THE FINAL WORD. AS A SMALL PRODUCER WITHOUT SUBSTANTIAL REFINING OR MARKETING FACILITIES, TRICENTROL MAY IN FACT BE DELIGHTED TO SEE BNOC PICK UP ITS OPTION AT AN EARLY DATE. THERE ALREADY HAS BEEN SOME DIFFICULTY AND COMPLAINT BY THE SMALLER OIL COMPANIES PRODUCING FROM THE ARGYLL FIELD THAT THEY HAVE BEEN UNABLE TO OBTAIN WHAT THEY CONSIDER TO BE AN ADEQUATE PRICE IN THE MARKET FOR THEIR CRUDE. CONVERSELY, THE MAJOR INTEGRATED OIL COMPANIES VERY MUCH WANT TO MAINTAIN ACCESS TO THEIR NORTH SEA CRUDE AND WILL RESIST VIGOROUSLY EFFORTS TO AFFORD BNOC AN OPTION ON A MERE SIX MONTHS NOTICE TO ALL FOR 1 PERCENT OF THE OFFTAKE.

IT IS LIKELY THE MAJORS WILL INSIST, AND HMG WILL ACCEDE, TO ONE OR BOTH OF THE FOLLOWING ALTERNATIVES:

A) AN OIL COMPANY OPTION TO "BUY BACK" ALL OR A PORTION OF BNOC'S 51 PERCENT SHARE OF CRUDE OVER X NUMBER OF YEARS, AND/OR

B) A BNOC OPTION TO BUY AT MARKET PRICE AN INITIALLY SMALL PERCENTAGE OF CRUDE ATTRIBUTABLE TO ITS 51 PERCENT INTEREST, AN AMOUNT WHICH COULD INCREASE TO 51 PERCENT ON A GRADUAL, PHASED BASIS OVER X NUMBER OF YEARS.

11. THE EMBASSY EXPECTS THAT CONTROL OVER DISPOSITION OF CRUDE WILL BE THE MOST DIFFICULT ISSUE TO RESOLVE. ONE REASON FOR THIS IS THE DETERMINATION ON THE PART OF MANY HMG OFFICIALS TO ASSURE THAT BRITAIN HAS AT LEAST INDIRECT LEVERAGE IF NOT CONTROL OVER THE EVENTUAL DESTINATION OF CRUDE SHIPMENTS DURING TIME OF CRISIS OR EMBARGO. THIS COULD APPLY PARTICULARLY TO BRITAIN'S EUROPEAN COMMUNITY PARTNERS WHICH ARE GUARANTEED FREE ACCESS TO NORTH SEA CRUDE UNDER ROME TREATY ARTICLE 134. IT IS NOT HARD TO IMAGINE BNOC IMPLYING THAT IT WOULD EXERCISE ITS OPTION TO TAKE OIL IN KIND IN THE EVENT A PARTICULAR COMPANY WOULD NOT HEED ITS CONDITIONS AS TO

APPROPRIATE SALES DESTINATIONS. IT HAS ALSO BEEN SUGGESTED BY SOME THAT, GIVEN THE POTENTIAL FOR INCREASING CONFIDENTIAL

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US IMPORTS OF FOREIGN OIL INTO THE 1980S AND THE EXTENT OF OWNERSHIP NORTH SEA RESERVES BY US-BASED COMPANIES, THIS INDIRECT INFLUENCING OF COMPANY DECISIONS MIGHT EXTEND TO SHIPMENTS TO THE UNITED STATES. THESE CONSIDERATIONS MIGHT BE OF MORE THAN MARGINAL IMPORTANCE IN THE EVENT THE EMERGENCY SHARING PROVISIONS OF THE INTERNATIONAL ENERGY PROGRAM WERE NOT IN OPERATION.

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